SACRAMENTO PRESS CLUB
Monday, May 7, 2007
Sterling Hotel

I realize I'm new to many here and I appreciate the opportunity to address the Capitol Press Corps and the Sacramento Press Club. Let me share a bit of my background and what I hope to accomplish as Controller.

After I graduated from the Georgetown University Law Center, I was a tax law specialist for the Internal Revenue Service. I later served as an attorney in the Controller's Office before being elected to the Board of Equalization, where I served two terms as an elected member for the 4th District.

I have been involved in tax and fiscal policy for a decade, and I welcome the opportunity to deal with these policies on a broader platform as the state's chief financial officer.

As Controller, I serve on 76 boards and commissions that significantly impact the state's economic health in areas such as economic development, employment, housing and the environment.

To increase our global competitiveness, and as the world's 8th largest economy, we must also have world-class fiscal expertise. I want the Controller's Office to be a leading resource for state policy makers and an asset to local governments as they navigate complex state financial reporting and auditing requirements.

Most importantly, I want to ensure that we maximize the benefit of each taxpayer dollar to provide the quality education, health care and public safety that Californians expect, and are entitled to, from their state government.

Let me share some of what we have done in the first few months to improve the state's fiscal operation:

- We have initiated a new program that, for the first time, will provide training for more than 1,000 state financial employees about the state's payment and cash management systems.

- We have started an extensive outreach to school districts and other local agencies to provide them with training and information to help them comply with financial reporting and accounting requirements.

- And we are creating an aggressive auditing program to ensure that public projects funded with the record, $42.7 billion-dollar bond package approved in November, are realized on time and on budget.

Last week we announced that state revenues are looking brighter because the amount of Personal Income Tax revenues received in April set a new monthly record – the State netted just over $12 billion in personal income taxes.

While this is good news, it would be premature – and fiscally irresponsible – to start thinking about increased spending until we see more details, such as how estimated tax payments for individuals and corporations are performing, which will give us a better indication of what we can expect in future revenues.

We will provide more information on Thursday, when we release our fiscal-year figures through the end of April.

As Controller, I publish, by the 10th of every month, the most up-to-date numbers for the fiscal year through the month just ended.

In the past, this information has primarily been used by bond rating and state fiscal control agencies, such as the Legislative Analyst's Office, legislative budget committee staffs and the Department of Finance. Some of you may have used them in preparing state budget stories.

Californians deserve to have easy access to factual, timely information about the state's fiscal condition. And they should have the information in an understandable and objective context, no matter if revenues are high or low.

That is why I have started providing a monthly analysis with this report, to let the public know what the cash-flow figures really mean. I think the public wants to know, and should have access to, information about how a Google going public helps boost our coffers, or how the two successful tax amnesty programs of the past few years sped up our receipts and provided much needed – but one-time – boosts to the General Fund.

I have recently appointed a seven-member council of some of the brightest economic minds in the state. Starting in June, our analyses will include the insights of these experts on a wide range of financial issues, from the real estate market to the cost of chronic disease to California's economy.

Our next analysis will be posted on our website on Thursday. My intent is to help you and the public better understand the implication of any trends we identify, and to provide a meaningful picture of the state's fiscal health.

And I'm very serious when I say I want your feedback on how we can make these analyses more useful to you, as you cover the state and how it spends the taxpayers' money, One of my priorities in bringing fiscal responsibility to the state was to move quickly to obtain an accurate figure on what the state's financial obligation is regarding the costs of providing health benefits to retired state workers.

I said I would try to avoid acronyms during this speech, but some are unavoidable. I'm sure at least some of you already are familiar with the term GASB 45, which stands for the Governmental Accounting Standards Board Statement No. 45.

Simply, GASB 45 is a national accounting requirement for California and other states to publicly disclose to Wall Street, and taxpayers, the dollar amount of their obligation to pay for post-retirement health benefits for state workers.

Typically, state and local governments pay the cost of retiree health benefits as they come due each year, often referred to as "pay-as-you-go." But in 2004, the Accounting Standards Board adopted the position that the current "pay-as-you-go" method does not accurately reflect the true costs that public agencies are accruing, or, in other words, the amount we will have to pay down the road when current state employees retire.

So, under these new accounting standards, California is required to disclose what the future costs for these benefits are by March 2009.

When I became Controller in January, I decided to determine the cost of California's obligation now, as opposed to two years from now. The sooner we address the problem, the less costly the solution.

Providing the data nearly two years in advance gives public policy makers additional time to engage in a candid discussion about how to craft a fiscally prudent plan.

We must protect the state's financial resources – those funds that:

- Pay for the programs and services that grow the state's economy
- Strengthen our social fabric, and
- Improve our quality of life.

But we also must honor the retirement promises we've made to our public servants. I believe we can do both with a prudent plan. And I believe we must do both, from a fiscal, legal and moral perspective.

Let me make this clear. The amount of the unfunded liability for state retirees' health care benefits will have no bearing on our credit or fiscal ratings – unless we do nothing.

It may not impact the Governor's May Revise next week, or the budget for the upcoming fiscal year. But it is an obligation that budget writers must start thinking about, beginning today.

You should remember that it took us 46 years to get here, and we're not going to fix it in a year, or two. Think of it less like we're competing in a 50-yard dash, and more like we've entered a marathon.

As long as we come up with a methodical, responsible plan to pay for these future obligations, we will satisfy the bond and credit rating agencies, and we will fulfill our promise to state workers and to the citizens who depend on the state for vital public services.

Currently, California, like many other states, uses the pay-as-you-go plan, meaning we pay the costs of retirement benefits as they come due.

Now, we all know what the Legislative Analyst's Office said last year: Our current approach has led to unfunded liabilities relating to retiree health benefits of between $40 billion and $70 billion.

So, here is what we have identified:

If we change nothing and continue on a pay-as-you go basis, we face an unfunded liability of $47.88 billion over the next 30 years. That's the difference between current assets and what we'll need down the road to pay for future health benefits – $47.88 billion.

However, if we decide to begin fully pre-funding the obligation, starting now, our liability over the next 30 years drops to $31.28 billion. The reason this amount is significantly lower is because pre-funding the cost of these benefits allows the state to earn a much higher yield, as compared to simply funding the benefits on a pay-as-you-go basis. That higher yield lowers the state's liability.

Currently, we pay, annually, a little less than $1.4 billion from General Fund and other sources.

Our actuarial report shows that, annually, if we continue on the pay-as-you-go basis, we will accrue a liability of $3.59 billion a year. But, if we fully pre-fund and put that money into a trust fund, we'll only need $2.59 billion a year to cover this liability.

These are big numbers, but they are not insurmountable.

We need not panic, or rush to judgment.

I cannot emphasize this enough: This obligation was not a crisis 30 years ago, it was not a crisis yesterday and it is not a crisis today. And, if we work toward a plan to pay this obligation in a reasoned manner – it will not be a crisis 30 years from now. That is what Wall Street and the taxpayers of California expect and deserve.

In the weeks and months ahead, the Governor's Commission will be vetting different options to address this obligation. We must work toward containing health care costs. Collective bargaining also should play a role as employers and employee groups must come together at the bargaining table to work on ways to fund current and future benefits.

No matter what other options are considered, California must start pre-funding its state retiree health benefits. Fiscal prudence demands that.

Pre-funding is the path we have taken since the early 1930s to pay pension benefits for state workers. It allows the state annually to pay into a fund that is set aside and invested, with those earnings today paying for 75% of the benefits paid out – or 75 cents of every dollar in benefits paid.

If we pre-fund retiree health benefits, our investment earnings can help supplement state and retiree contributions. It will help the state meet its obligation to pay for these benefits, and help pay off the unfunded liability for retiree health costs.

By fully pre-funding, we would reduce the obligation on the state of California by more than $16 billion over the next 30 years. And fully pre-funding would reduce the annual contribution the state should make by $1 billion.

Wall Street is not looking for drastic changes and they are not necessary. With a steady funding plan, we can meet our obligation and our promise to state workers.

I pushed to have this actuarial valuation completed two years in advance so we would have time to carefully craft a fiscally solid plan to address this obligation. Time is money. And the time has come when we simply cannot keep deferring the costs of retiree health benefits to the next generation of Californians.

GASB 45 requires states to disclose the total cost of providing health benefits to state employees. With this report, I am presenting the magnitude of the obligation that we have incurred. The next step is to develop a plan to address the obligation.

The Governor, the Legislature and state employee representatives have much work ahead of them. I have faith that they will craft a responsible plan, and I offer myself and my office to assist them.

I look forward to working with all of the parties to ensure we meet our fiscal obligations, deliver on our promise to state workers, and protect our resources so we can continue to provide the services Californians expect, and deserve.

With that, I'd like to invite Alex Rivera, with the actuarial firm of Gabriel, Roeder, Smith & Company of Chicago, to join me and answer any questions related to the actuarial report. Thank you.